

CHAPTER 8: SECURITY RESTUCTURING REQUESTS

8.1 INTRODUCTION

During the term of an Agency loan, borrowers may face unexpected expenses or other financial difficulties that require additional financing from other sources to adequately maintain and operate the project. In such cases, the Agency will consider restructuring the borrower's security, so long as doing so will not only help the property, but also be in the best interest of tenants and the government. Potential security restructuring activities that may be approved include subordinations and junior liens, disposition of security property, leasing of security property, and other liens against a property or other assets.

This chapter describes the requirements regarding such security restructuring requests, and Agency procedures for reviewing and approving those requests.

SECTION 1: SUBORDINATIONS AND JUNIOR LIENS

[7 CFR PART 3560.409]

8.2 OVERVIEW

Borrowers may request a subordination or junior lien for any type of Agency loan. Prior Agency consent is required for all subordinations and junior liens.

Because the requirements and procedures for subordinations and junior liens are so similar, they have been combined in this section. Where necessary, specific differences between the requirements and procedures for the two have been identified.

8.3 REQUIRED CONDITIONS

The State Director may grant consent to subordinations or junior liens if the borrower adequately documents that the request is consistent with the conditions listed in Exhibit 8-1.

If a junior lien is placed on any property without prior Agency consent, the State Director may pursue liquidation of the account.

Exhibit 8-1**Required Conditions for Subordinations or Junior Liens**

- The action will enable the borrower to obtain credit to make needed improvements or repairs on the property in circumstances where a loan of the same type involved could be made and funds in the reserve account have been depleted. Repair costs should be reasonable and consistent with the local market;
- The action will improve the borrower's total financial condition or debt-paying ability;
- The borrower is unable to refinance the loan on terms that can reasonably be expected to be met yet still meet the intent of the program;
- The action will not result in an unauthorized rent increase for the project or result in basic rents that exceed conventional rents for comparable units;
- The lienholder agrees in writing that foreclosure action under its lien will not be initiated before holding a discussion with the Loan Servicer and after giving a reasonable period of notice to the Agency, and certifies that its operating plans are consistent with Agency requirements;
- Security for the subordination or junior lien appears adequate;
- The transaction must further loan objectives and not adversely affect the Agency's security;
- The subordination or junior lien is not associated with a transfer of ownership;
- The total debt against the security after the transaction does not exceed the appraised value of the property and is within the State Director's approval authority;
- The net cost to the Government of servicing the account will not increase following the action;
- There is no future advance clause that would allow the lender to advance additional money and maintain the security or mortgage position; and
- All other applicable regulatory requirements have been met.

8.4 EVALUATING BORROWER REQUESTS FOR SUBORDINATIONS AND JUNIOR LIENS

The State Director will approve subordinations and junior liens only if they generally improve a borrower's financial condition and allow for completion of improvements or repairs in cases of underfunded reserve accounts. Loan Servicers need to ensure that the request does not alter project operations to make it ineligible under Agency requirements. In addition, the subordination must not adversely affect the Agency's ability to service the loan according to program regulations, and must be determined to be within the bounds of good judgment considering the intent, funding limitations, and respective program authorities. When evaluating borrower requests for subordinations or junior liens, Loan Servicers will review the request and check that the requirements listed in Exhibit 8-2 have been met.

In most cases, the Agency will not require an appraisal of the property when a junior lien or subordination is proposed. For junior liens, appraisals are almost never required, provided project budgets demonstrate that the project has a sufficient income to support the increased debt. Appraisals are unnecessary in such cases because the Agency retains its lien position. For

subordinations, the Agency needs to look more closely at the amount of non-Agency debt being assumed and to determine whether its secondary lien position is sufficient security for the remaining outstanding debt. In some cases, this determination may require an appraisal. In either case, the Agency needs to determine whether projects are still in compliance with conventional rents for comparable units and standards following the subordination or junior lien. The State Director decides when appraisals will be required.

All requests for consent to subordinations or junior liens that do not satisfy the criteria of Exhibit 8-2 must be submitted to the National Office with complete comments and recommendations from both the Loan Servicer and State Director, and all of the borrower's case files. The National Office will review such requests on a case-by-case basis, and appropriate authorization will be granted or withheld depending on the individual merits of the proposal and its compatibility with program requirements.

Loan Servicers should follow the procedures in paragraph 8.5 when evaluating these requests.

8.5 PROCEDURES FOR AUTHORIZATION OF SUBORDINATIONS AND JUNIOR LIENS

A. Borrower Requests

The process of requesting a subordination or junior lien usually begins with a telephone call from the borrower to the Loan Servicer to discuss the plans for restructuring security. Loan Servicers should instruct the borrower that each request for subordination or junior liens must be submitted on *Form RD 465-1, Application for Partial Release, Subordination, or Consent*, and provide a copy of the form to the borrower.

Exhibit 8-2**Requirements for Agency Consent to Borrower Requests for Subordination or a Junior Lien**

Loan Servicers may approve borrower requests only if they adequately document that the following requirements have been satisfied.

- The account must be brought current.
- The debt must be adequately secured.
- The borrower must provide adequate management.
- The terms and conditions of the prior lien or junior lien must be such that the borrower can reasonably be expected to meet them as well as all other debts.
- The proposed use of funds must not adversely affect the borrower's ability to meet the objectives of the program. Indeed, it must improve the borrower's ability to repay the loan or be necessary to place the borrower's operation on a sound basis.
- When an increase in the amount of a prior lien or a new prior lien is involved, the funds must be used for the same purposes for which the Agency loan is authorized, except that Labor Housing loans on farm tracts may be subordinated for essential farm improvements and operations. Labor Housing loans may not be subordinated to provide operating capital or to purchase chattels.
- Any proposed development must be planned and performed according to RD Instruction 1924-A, Planning and Performing Construction and Other Developments, or in a manner directed by the other lienholder that meets the objectives of RD Instruction 1924-A.
- Funds to be used for development or enlargement of farm operations must be handled as prescribed for loan funds in RD Instruction 1902-A, Disbursement of Loan, Grant, and Other Funds, except that if the lienholder will not permit the use of a supervised bank account, arrangements must be made to ensure that funds will be spent for planned purposes and must be approved by the Agency before being released.
- In case of land purchase, the Agency will obtain the best lien available on the land purchased.
- The appropriate level of environmental review under the National Environmental Policy Act (NEPA) must be completed.
- *FEMA Form 81-93, Standard Flood Hazard Determination* must be completed.
- Subordinations or junior liens need not cover the entire site (If a subordination or junior lien is requested to permit an interim lender to advance construction funds, only the portion of the site scheduled for construction will be affected by the action. For Agency multi-family housing loans, the prorated portion of the lien for the individual lots may be subordinated or subject to a junior lien to permit construction of dwelling units using conditional commitments as authorized in program regulations).
- The subordination or junior lien must be for a specific amount.
- The subordination or junior lien must not adversely affect the Agency's ability to service the loan according to the requirements of this part.
- New prior or junior lienholders must agree to provide notice of foreclosure to the Agency, as required in RD Instruction 1927-B, Real Estate Title Clearance and Loan Closing. Any junior lienholder's consent to the foreclosure and use of proceeds will be obtained prior to approval of the foreclosure.

B. Processing Borrower Requests

Upon receipt of the completed form, Loan Servicers will make a preliminary feasibility determination regarding the request. Key areas that the Agency will analyze as part of this determination include:

- Rates and terms;
- Post-restructuring project budget;
- Current compliance status of the property; and
- Capacity (for nonprofit borrowers).

If Loan Servicers discover violations at the property, the request must not be approved without an Agency-approved work-out agreement.

C. Recommendations to State Director

If there are no violations at the property, and all other applicable criteria are met, Loan Servicers forward a properly completed and executed copy of *Form RD 465-1, Application for Partial Release, Subordination, or Consent*, to the State Director. Accompanying *Form RD 465-1* should be a memo containing all information needed to justify approval or disapproval of the request, including an agreement from any new prior lienholder to provide the Agency advance notice of foreclosure. As appropriate, Loan Servicers will also obtain junior lienholders' consent to any transaction and use of proceeds prior to approval of the transaction. When all required documentation has been assembled, the Loan Servicer will forward the subordination and junior lien request to the State Director for review.

D. Final Decision

If the State Director or his or her designee agrees with the Field Office determination, he or she will forward the subordination or junior lien request to OGC for review of legal sufficiency and closing comments. After OGC review, the closing process will begin. The State Director or his or her designee should obtain OGC guidance in the preparation of documents necessary to effect the subordination.

All subordination and junior lien requests exceeding the State Director's approval authority limit must be submitted to the National Office for prior approval authorization.

E. Appraisal Procedures

The State Director may request an appraisal at any time deemed appropriate. As stated in Section 8.4 above, most subordinations and junior liens will not require an appraisal. If an appraisal is deemed necessary, an Agency official authorized to make appraisals for the type of project involved will prepare an appraisal report. Alternatively, the new creditor may perform the appraisal as part of the due diligence process. If an

appraisal that is less than one year old is available, it may be used in lieu of a new appraisal.

8.6 POST-APPROVAL OF JUNIOR LIENS

Sometimes a borrower will obtain additional credit (e.g., a personal loan) using the project as security for that credit, despite the Agency's requirements that prohibit such actions. In effect, that loan functions as a junior lien on the property. When a junior lien is placed on any property without the prior consent of the Agency, the Loan Servicer will normally service the account for liquidation with the guidance of OGC. However, the State Director may request permission to post-approve the junior lien by submitting a formal request to the National Office, provided he or she determines that the junior lien does not impair the government's security interest and all other applicable conditions are met.

SECTION 2: PARTIAL DISPOSITION OF SECURITY PROPERTY

[7 CFR 3560.407]

8.7 OVERVIEW

Borrowers may also request Agency approval of the sale of a portion of an interest in the security property under certain circumstances. The borrower may use the proceeds from such sale in accordance with Exhibit 8-3. Alternatively, a borrower could grant a conveyance or right of way easement, among other actions. This section addresses each of these options, and the Agency's procedures for reviewing and approving requests.

Exhibit 8-3

Allowable Uses for Proceeds from Disposition of Security Property

- To pay customary incidental closing costs such as title and recording fees appropriate to the transaction, including additional real estate tax the borrower is required to pay for the year for which alternate arrangements to pay cannot be made.
- To pay debts owed to any prior lienholders.
- To make extra payments on the loan.
- To pay costs necessary to determine the reasonableness of an offer or asking price, such as fees for appraisal of minerals, land, or timber where the necessary appraisal cannot be obtained without costs.
- To pay a real estate broker's commission if the borrower can reasonably expect to obtain proceeds at least equal to the commission in excess of what could otherwise be obtained without the broker's assistance.
- To repair, develop, or enlarge the borrower's facility for purposes for which a loan of the same type involved could be made, if the development or enlargement is necessary to improve the borrower's debt-paying ability, place the operation on a more sound basis, or otherwise further loan objectives.
- To purchase or acquire property to be used for purposes for which a loan of the same type involved is authorized, if the debt will be as well secured after the transaction as before. The Agency will obtain a lien on the acquired property, and obtain title evidence.
- To increase reserves based on an Agency-approved capital plan.
- To pay any additional income tax that must be paid for the year because of the capital gain tax attributable to the transactions. Funds for taxes must be estimated and held in a supervised bank account until actual payment of the tax.
- To pay investor capital losses or recaptures of capital gains, if funds are available after all of the above factors have been considered.

8.8 ALLOWABLE ACTIONS INVOLVING THE PARTIAL DISPOSITION OF SECURITY PROPERTY

The State Director may grant consent to requests for the following actions involving the partial disposition of security property for a project:

- Use of proceeds from the sale of a portion of or an interest in the security;
- Exchange of all or a part of the undeveloped security for other real estate; or
- Granting or conveyance or rights-of-way subject to applicable conditions and requirements.

8.9 ALLOWABLE USES FOR PROCEEDS FROM PARTIAL DISPOSITION OF SECURITY PROPERTY

The Agency may consent to the partial disposition of security property if borrowers plan to use the proceeds for one or more of the uses listed in Exhibit 8-3.

It should be noted that while borrowers may use proceeds from disposition of security property for any of the purposes listed in Exhibit 8-3, there is a priority order for using such proceeds. All obligations to the Agency and all other prior obligations must be satisfied before proceeds may be used to pay capital gains taxes or investor capital losses or recaptures. Any funds used for these purposes must be in excess of all other obligations. The order in which the allowable uses are listed in Exhibit 8-3 roughly corresponds to the Agency's preferred priority order (although not all uses will apply to all projects).

For example, if one building at a project is sold, and the borrower pays off all obligations related to that building to the Agency, pays all other related expenses, and still has a surplus of \$5,000, that money may be used to pay investors in the project so long as the loan would remain secured following such action.

If property to be sold or exchanged is to be used for the same or similar purposes for which the loan or grant was made, the purchaser is required to execute *Form RD 400-4, Assurance Agreement*. The agreement will remain in effect for as long as the property continues to be used for the same or similar purpose for which the loan or grant was made.

8.10 REQUIRED CONDITIONS FOR AGENCY CONSENT

The State Director may grant consent to partial sales of security property, including the sale of individual units or developed portions of a multi-family housing project, so long as the conditions listed in Exhibit 8-4 are met.

8.11 PROCESSING BORROWER REQUESTS

The Agency grants consent to disposition of part of, or an interest in, security property by approving a completed *Form RD 465-1, Application for Partial Release, Subordination, or Consent*, or other forms approved by OGC or prescribed in State Supplements.

Exhibit 8-4**Required Conditions for Agency Consent
to Partial Disposition of Security Property**

- The transaction will not impair orderly payment of the Agency debt.
- The transaction will not interfere with the successful operation of the project or prevent the borrower from carrying out the purpose for which the loan was made.
- The borrower certifies compliance with fair housing laws.
- The appropriate level of environmental review under the National Environmental Policy Act (NEPA) is completed and mitigation measures to protect any important resources are established.
- The consideration is at least equal to the market value of the security property disposed of or the rights being granted, except that right-of-way easements may be granted or conveyed without consideration being offered or with only the minimal consideration being offered if the value of the security property will not be reduced, its suitability for the intended purpose will not be impaired, and the easement is granted for the borrower to develop additional lots or units that will be integrated into the project or with a public body for enhancement of streets or utilities benefiting the project.
 - In order to establish market value, an authorized Agency official will either make a new appraisal if the current appraisal is more than one year old, or supplement the present appraisal report by inserting information as to the market value of the security disposed; or
 - The approval official may also accept a value determination for such easements that have been provided by other competent sources at no cost to the government that is mutually acceptable to the borrower and the Agency.
- The remaining property is adequate security for the unpaid balance of the loan.
- The proceeds from the disposition of the security are to be used for one or more approved purposes (e.g., to pay closing costs, make extra payments, pay brokers' commission).

A. Borrower Submission

When a borrower requests consent to lease a portion of the security property or the Loan Servicer discovers that the borrower is leasing the security without consent, the Loan Servicer will require the borrower to complete *Form RD 465-1, Application for Partial Release, Subordination, or Consent*. The form will show the terms of the proposed lease and will specify the use of proceeds, including any proceeds to be released to the borrower.

B. Agency Review

The Loan Servicer will forward to the State Director:

- A properly completed and executed *Form RD 465-1, Application for Partial Release, Subordination, or Consent*;

- The proposed deed, easement, or other form of title conveyance;
- The case file;
- A memorandum from the Loan Servicer justifying the approval or disapproval of the proposed transaction; and
- Any other information pertinent to the transaction.

The State Director will review the materials; obtain the guidance of OGC, if needed, prior to indicating approval or disapproval on *Form RD 465-1*; and provide additional servicing instructions to the Loan Servicer.

C. Agency Decision and Notice to Borrower

Before the Agency consents to any transaction that affects its security or lien position, Loan Servicers must obtain the written consent of any other lienholders. Such consent should include an agreement on the disposition of any funds resulting from the transaction and must be consistent with loan program requirements.

Loan Servicers should advise the borrower if the mortgage or deed of trust requires Agency consent to the sale or other transfer of real estate security. In such cases, the Loan Servicer should explain the applicable requirements to the borrower.

8.12 AGENCY RELEASE OF SECURITY

The Agency will release security for Agency loans in accordance with applicable program regulations and as follows:

- The Agency will not release its lien until it receives from the borrower the appropriate sales proceeds for application on the Government's claim. Loan Servicers will hold borrowers strictly accountable to the Agency for all proceeds derived from the sale of mortgaged property that the Agency is entitled to receive under its lien.
- The State Director may authorize the release of chattel security from a chattel mortgage by using *Form RD 460-1, Partial Release*, or other approved form, and from a security interest under the Uniform Commercial Code by use of *Form RD 462-12, Statements of Continuation, Partial Release, Assignment, etc.* OGC guidance may be obtained in such cases, if needed.
- The State Director or his or her designee may release real estate security by using *Form RD 460-1, Partial Release* or other form approved by OGC. Satisfaction or termination of real estate security instruments when the Agency debt has been paid in full or satisfied by debt settlement action will be accomplished with *Form RD 460-4, Satisfaction*.
- Any consent that results in an Agency loan account being paid in full is subject to all applicable prepayment provisions.

SECTION 3: LEASING OF SECURITY PROPERTY [7 CFR 3560.408]

8.13 OVERVIEW

Borrowers must obtain Agency approval to lease security property serving as security for Agency loans and grants. The Agency may approve leases to tenants for specific program purposes or otherwise at its discretion.

8.14 LEASES TO PUBLIC HOUSING AUTHORITIES

Loan Servicers may authorize multi-family borrowers to renew and continue leasing all or part of their housing facilities to a housing authority, although borrowers may not enter into any new leases. Such leases must be on a form provided by the housing authority, and Loan Servicers must determine that the lease terms will enable the borrower to continue the objectives of the loan and make payments on schedule.

8.15 LEASE OF A PORTION OF THE SECURITY PROPERTY

Loan Servicers may approve the leasing of related facilities such as kitchens, recreation facilities, and community buildings when the borrower will continue to operate the facilities for the purposes for which the loan or grant was made. Loan Servicers should not approve such leases, however, unless they can verify that all of the following conditions are met:

- The lease is in the best interest of the borrower, the tenants, and the government.
- The amount of the consideration is adequate to pay all prorated operating and maintenance expenses, a prorated share of the annual reserve deposit, and the prorated part of the loan amortization at the note rate of interest.
- The lease provides at its termination for the restoration of the leased space to its original condition or to a condition acceptable to the owner and the government.
- Consent to the lease does not exceed three years at a time, unless a longer lease is clearly more advantageous to the borrower, the tenants, and the government.
- The borrower has obtained written consent from any other lienholders whose mortgages require consent to any lease.

8.16 MINERAL LEASES

The Agency handles mineral leases according to the requirements set forth in 7 CFR 1965.113.

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SECTION 4: OTHER LIENS AGAINST A PROPERTY OR OTHER ASSETS [7 CFR 3560.409 (d)]

8.17 OVERVIEW

If neither of the options presented in Sections 1, 2, or 3 of this chapter are applicable to a particular borrower or property, the Agency may consent to other liens against the property or other assets. The State Director may approve other liens against a property or other assets or instruments of similar effect under which a borrower may acquire—through other credit—items that will not become part of real estate security.

If additional liens are taken against other real property, the Loan Servicer must ensure that appropriate NEPA environmental review and due diligence requirements are satisfied.

8.18 REQUIRED CONDITIONS

The Agency's rule states that borrowers must not enter into any agreements placing a lien on the property or the equipment on it (e.g., items such as laundry equipment, air conditioning units, and basic household furnishings that will not become part of real estate security) without prior Agency approval and unless the following three conditions are met:

- The transaction will not affect the Agency's security position;
- The items covered by the transaction are needed for the successful operation of the property; and
- The financing arrangements are otherwise sound.

The rule also specifies that borrowers must complete and file with the Agency a financing statement and a security agreement.

8.19 AGENCY PROCEDURES

Requests for approval of other such liens will be made by the borrower on *Form RD 465-1, Application for Partial Release, Subordination, or Consent*. The Loan Servicer will forward to the State Director a properly completed and executed *Form RD 465-1, Application for Partial Release, Subordination, or Consent*, the proposed arrangement, the case file, and specific recommendations regarding the request.

The State Director will indicate approval or disapproval on *Form RD 465-1, Application for Partial Release, Subordination, or Consent*. The State Director will request that OGC prepare or approve the arrangement and issue special instructions when necessary.